

# Economic impact of the Middle East conflict

EY Economic Analysis Team

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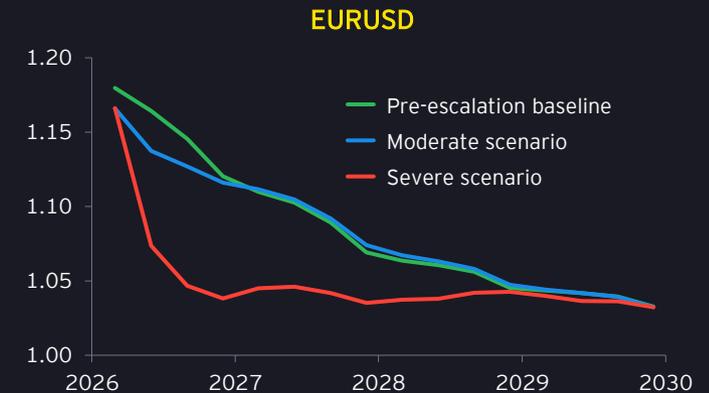
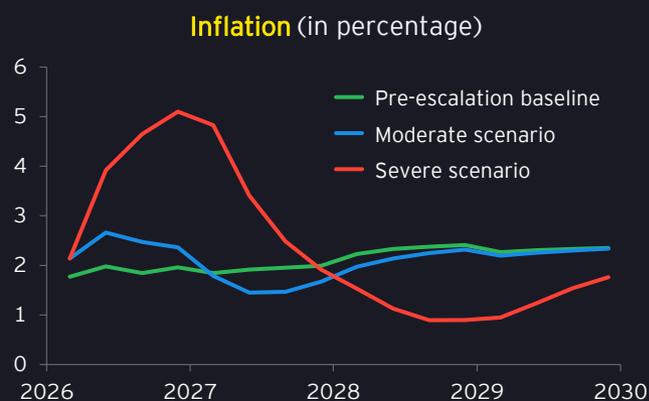
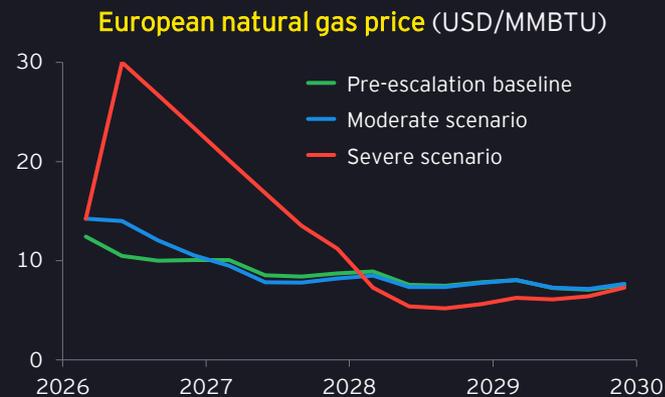
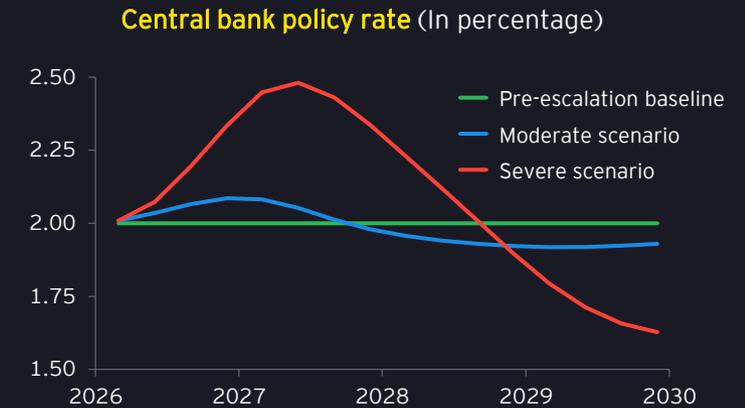
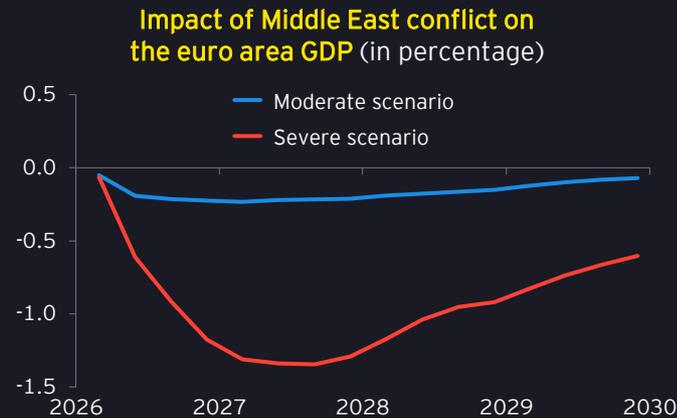
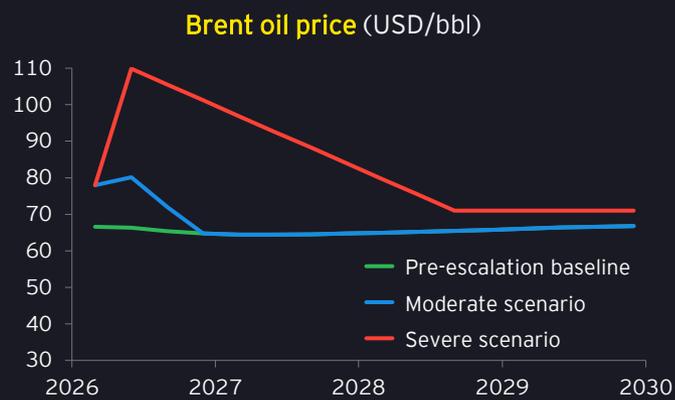
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# In the scenario of a temporary uptick in energy prices, the conflict in the Middle East could increase euro area inflation by 0.5 pp and reduce GDP by 0.2% in 2026. However, more extreme scenarios remain possible

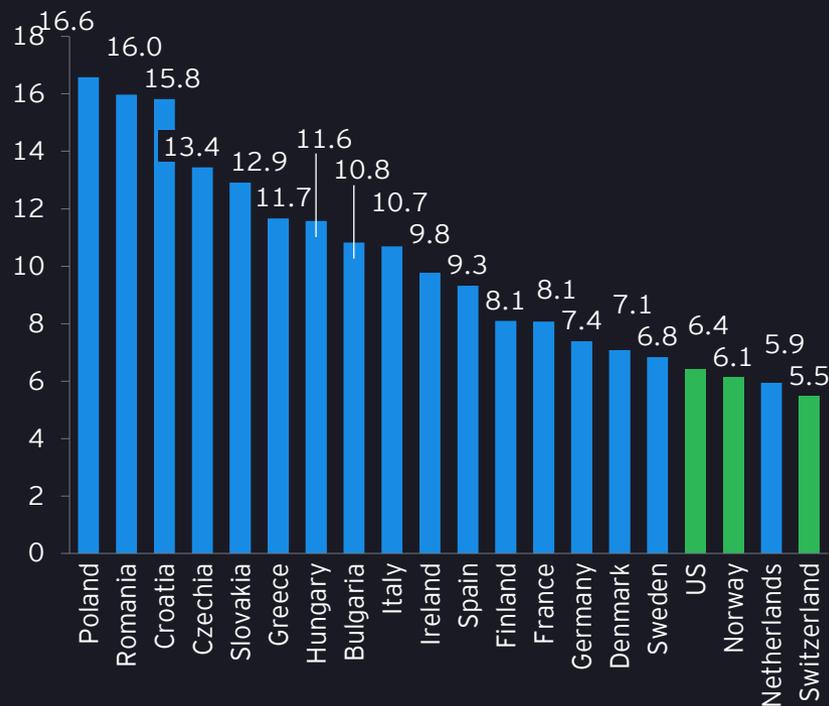
- ▶ If the conflict lasts for a few weeks and results in temporary disruptions to oil supply, we estimate that the increase in commodity prices, the reduction in consumer and business confidence, and some trade disruptions could push euro area inflation up by 0.5 pp in 2026 and reduce GDP by 0.2%. This would likely not be sufficient for the ECB to react.
- ▶ However, in a scenario of further escalation and a prolonged conflict, reduced oil production and a sustained closure of the Strait of Hormuz could raise oil prices by over USD 40/bbl, European gas prices by USD 20/MMBTU, and coal prices by 35% in 2026 Q2, with the shock fading only very gradually over subsequent quarters.
- ▶ We estimate that such a scenario would reduce euro area GDP by 1.3% by 2027 and push HICP inflation to around 5%, while core inflation would rise more moderately (by up to 0.9 pp). Given the opposing forces of weaker growth and higher inflation—but with only a relatively limited increase in core inflation—the ECB would tighten policy only modestly. As Europe would be hit harder by elevated gas prices than the US, our simulations indicate that the euro would depreciate by over 8% against the USD.



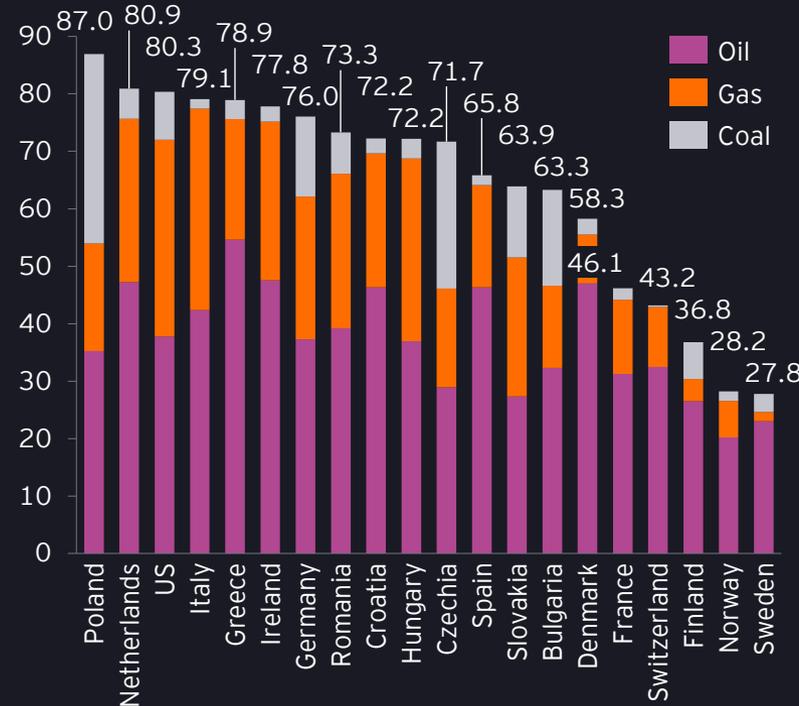
# Country-specific impacts on CPI inflation depend on the share of fossil fuels in the energy mix, the weight of energy in the CPI basket, and the degree of energy price regulation

- ▶ CEE countries are generally more exposed to energy shocks due to a relatively large share of energy in CPI baskets. However, a high degree of electricity and natural gas price regulation dampens the immediate pass-through to consumer prices.
- ▶ Italy and the Netherlands are more exposed than other Western European peers, reflecting a higher reliance on oil and gas and a relatively swift transmission of commodity price shocks to consumer energy prices. In the Netherlands, this effect is partly mitigated by a low energy weight in the CPI basket.
- ▶ Nordics tend to be less exposed due to more favorable energy mixes and a low share of energy in CPI baskets. That said, commodity price shocks transmit relatively quickly to consumer prices, particularly in Sweden.
- ▶ Relative to Europe, the US is less exposed, as local gas prices are less affected by the Middle East conflict, despite a relatively unfavorable energy mix and a high degree of energy price flexibility.

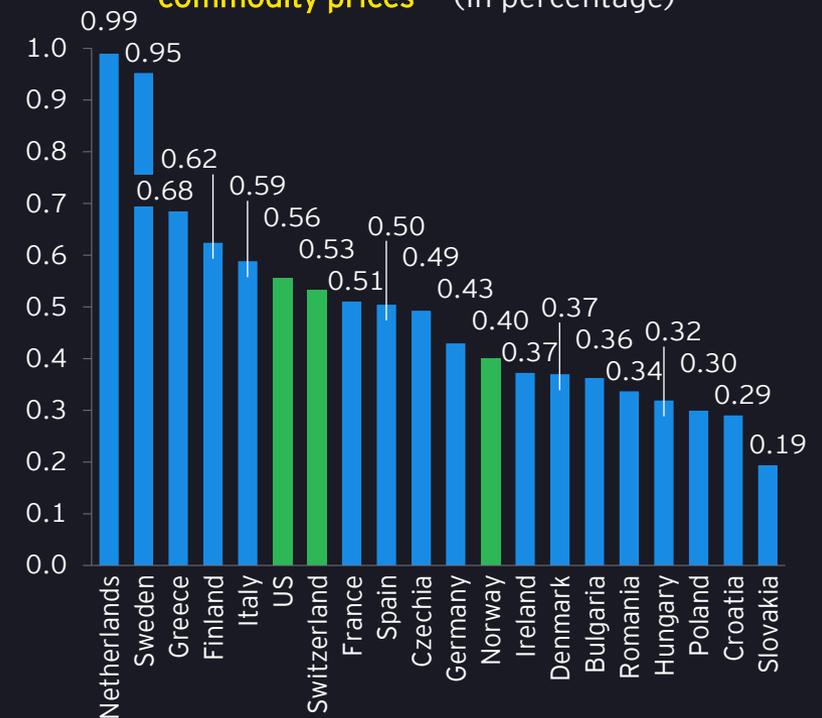
**Share of energy in the CPI basket in 2025**  
(In percentage)



**Share of fossil fuels in the energy mix in 2024\***  
(In percentage)



**Estimated average annual response of consumer energy prices to a 1% increase in underlying energy commodity prices\*\*** (In percentage)



Source: Oxford Economics; Our World in Data; EY EAT analysis.

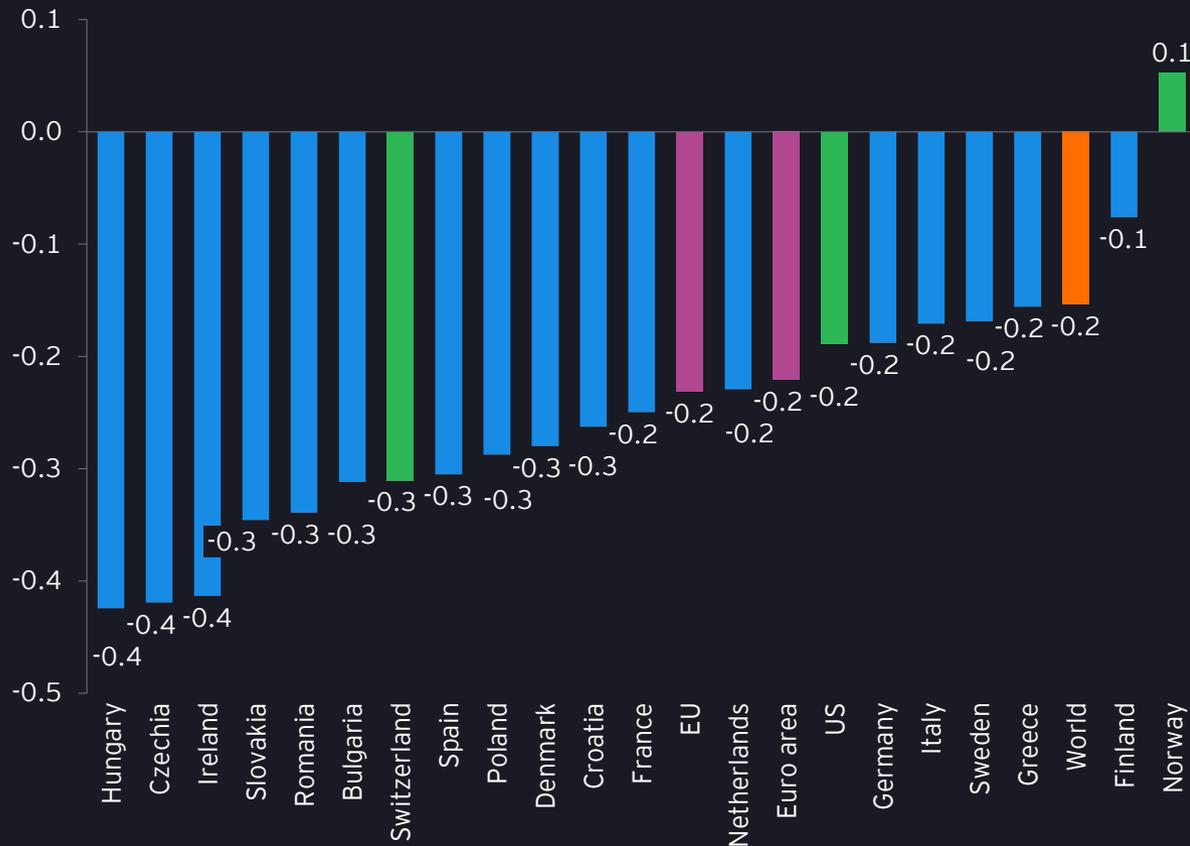
3 \* While Gulf countries are not a major supplier of coal, its price has increased due to a rise in oil and gas prices.

\*\* Underlying energy commodity prices are demand-weighted prices of oil, natural gas, coal, and electricity. The chart shows 2026 response of energy CPI to a shock assumed under the severe scenario.

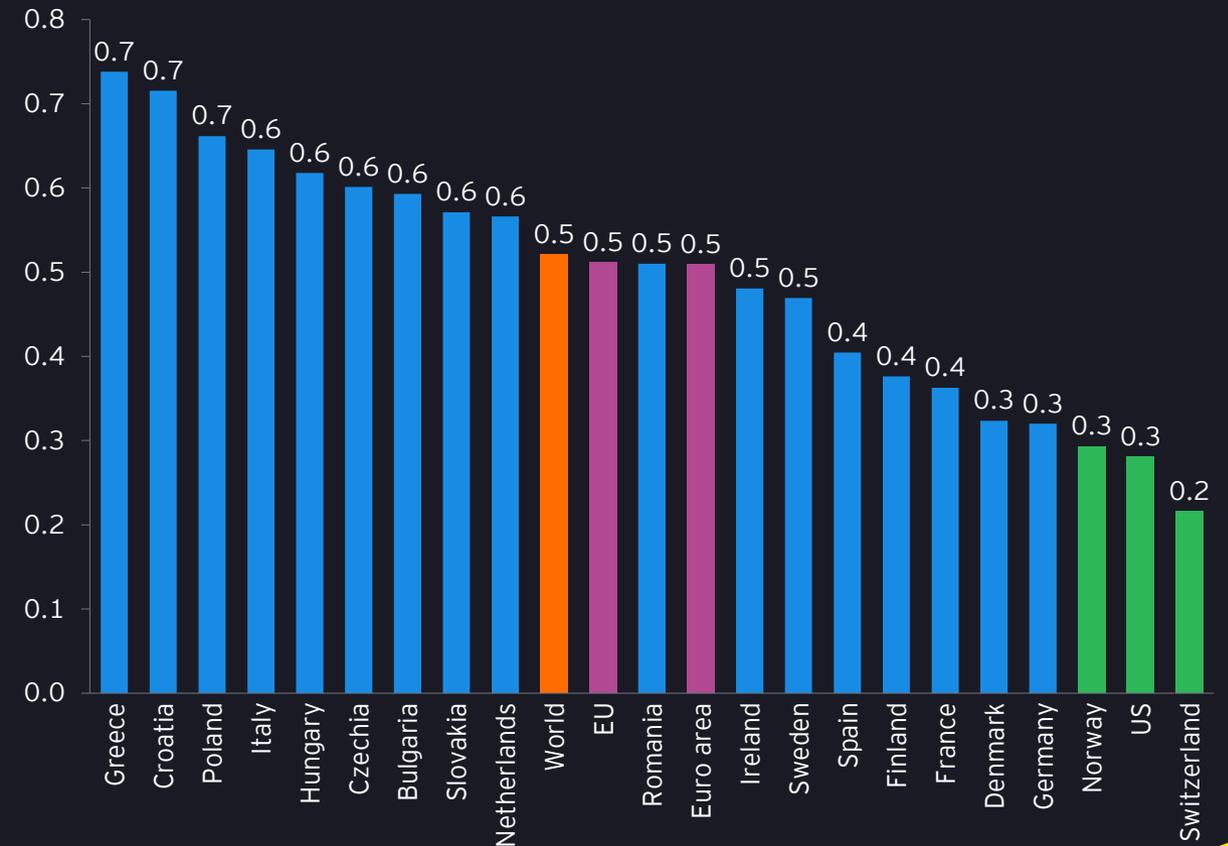
# Under the moderate scenario, the increase in 2026 inflation ranges from 0.2 pp in Switzerland to 0.7 pp in Greece and Croatia, with a cumulative drag on GDP by 2027 of up to 0.4%

- Exchange rate depreciation would support exports and investment in several countries, partly offsetting the negative impact of higher energy prices on competitiveness and household disposable income. Norway would be an outlier, benefitting from higher energy prices through increased oil and gas production and investment.

Impact of the conflict in the Middle East under moderate scenario on GDP level in 2027 (In percentage)



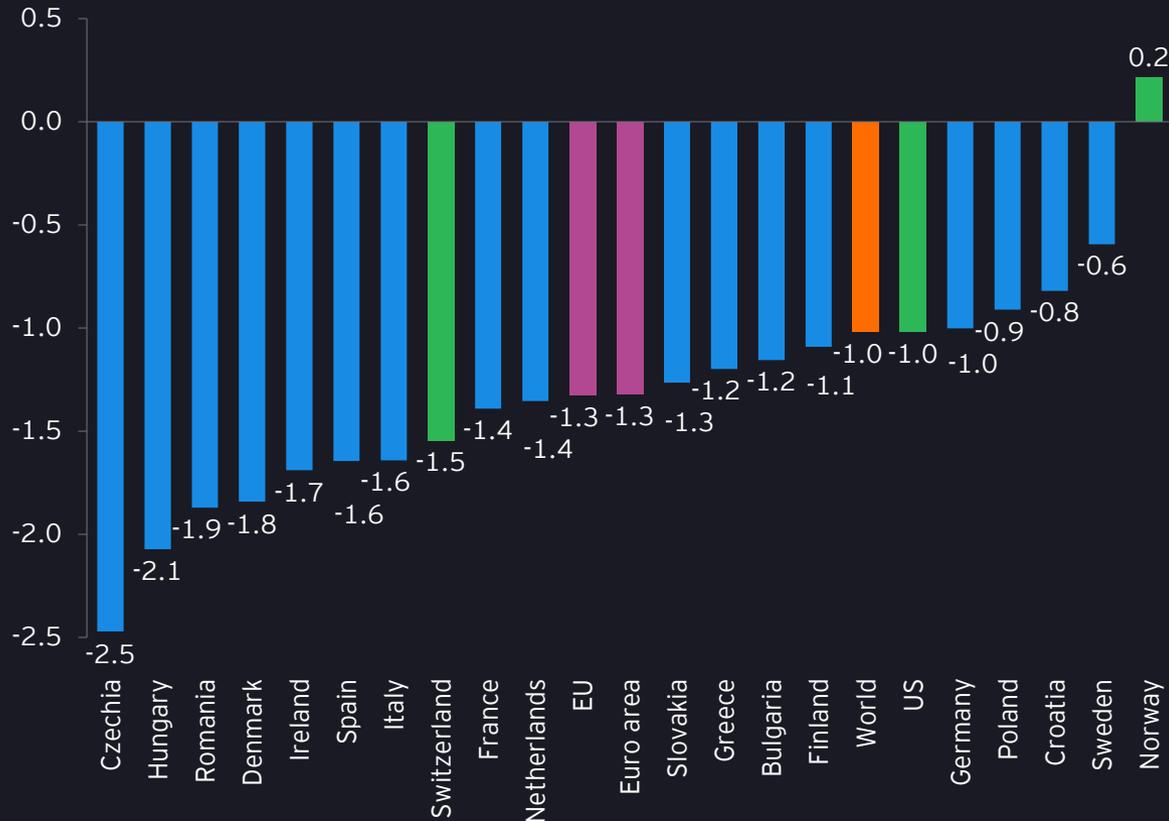
Impact of the conflict in the Middle East under moderate scenario on CPI inflation in 2026 (In percentage points)



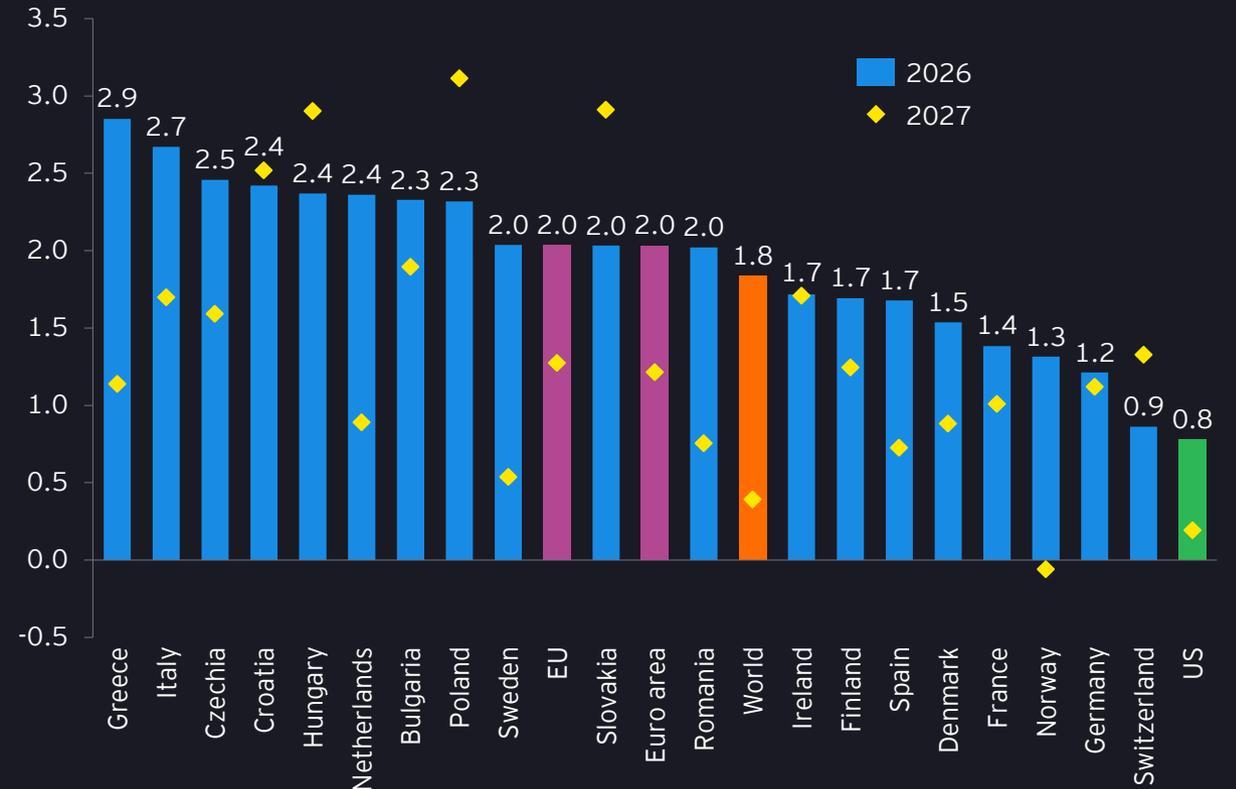
## Under the severe scenario, cross-country differences become more pronounced, although the overall ranking of countries by exposure remains broadly unchanged

- ▶ Norway would benefit from higher energy prices, reflecting increased oil and gas extraction as well as higher investment.
- ▶ CEE countries (Poland, Hungary, Slovakia) are expected to experience an above-EU-average increase in inflation in 2026, which would be significantly larger in the absence of electricity and natural gas price regulation. However, part of the impact is delayed, with a further increase in inflation in 2027 as regulated energy prices are lifted, while inflation in most other EU countries is already expected to ease.
- ▶ In the severe scenario, the inflationary impact of higher energy commodity prices is likely to be dampened by government countermeasures, such as temporary VAT and excise tax reductions or price freezes.

Impact of the conflict in the Middle East under severe scenario on GDP level in 2027 (In percentage)



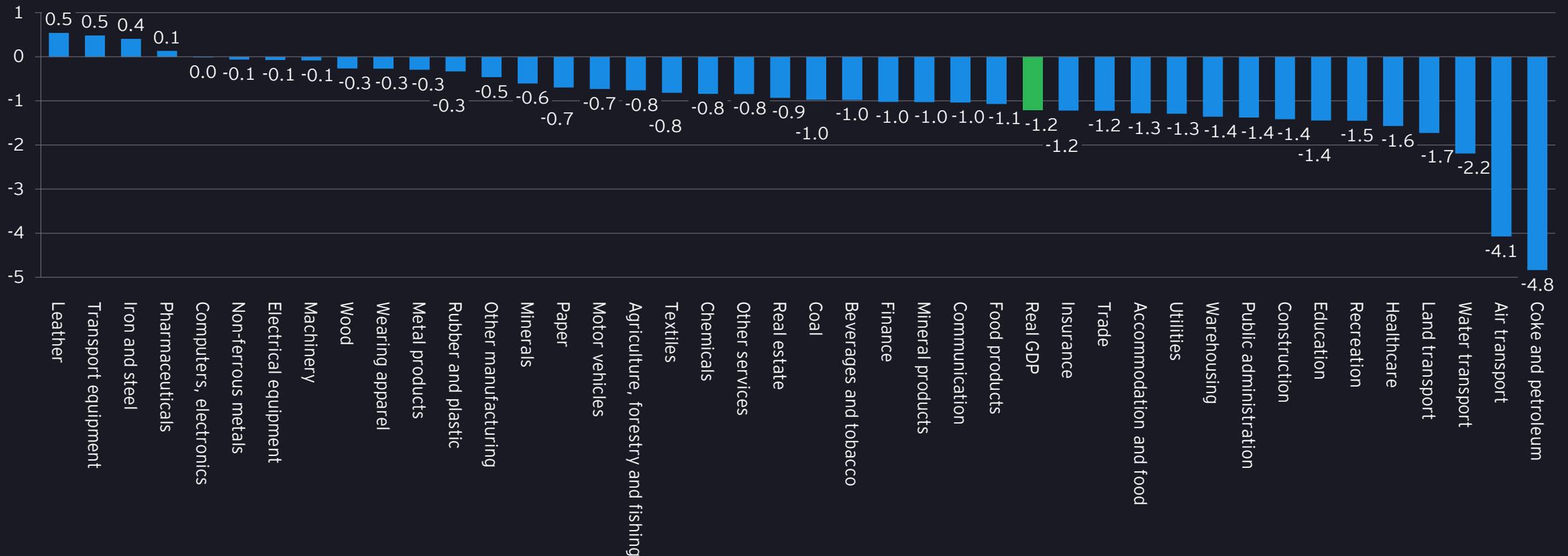
Impact of the conflict in the Middle East under severe scenario on CPI inflation (In percentage points)



# EU transport, refining, and services sectors are among the most negatively affected by higher energy prices stemming from the Middle East conflict

- ▶ Rising energy costs erode households' disposable income, reducing demand for discretionary services. As a result, activity declines across many service sectors, even though they are not energy-intensive themselves.
- ▶ Higher energy prices also raise production costs for non-EU competitors. Given that Chinese manufacturing is more energy-intensive than EU manufacturing, part of the negative impact on EU producers is offset by an improvement in their relative cost competitiveness vs. Chinese firms.
- ▶ After an initial profit boost, oil refining should see a reduction in real value added as higher prices reduce fuel sales in real terms and margins are squeezed by higher oil prices. That said, oil and gas companies are expected to more than recoup these losses through higher profits on mining activity.

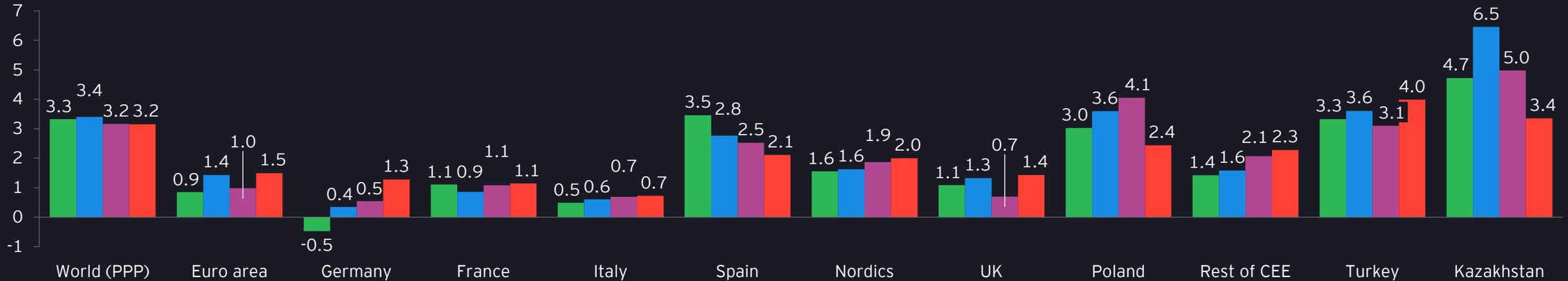
Impact on value added by sector in the EU in 2027 - severe scenario  
(percentage deviation relative to non-conflict scenario)



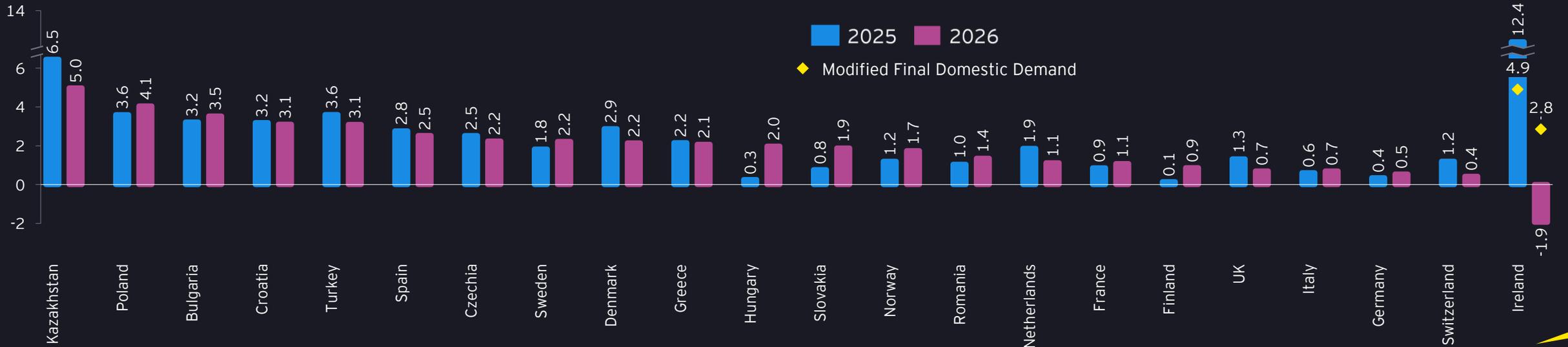
Source: EY simulations using the EY UPGRADE CGE model.

**We have adopted the moderate scenario as our baseline. Together with a downward revision to Ireland, this lowers the euro area GDP forecast for 2026 down from 1.3% to 1.0%, with limited changes in subsequent years**

GDP growth in 2024-2027 (in percentage)



GDP growth in 2025 and 2026 (in percentage)

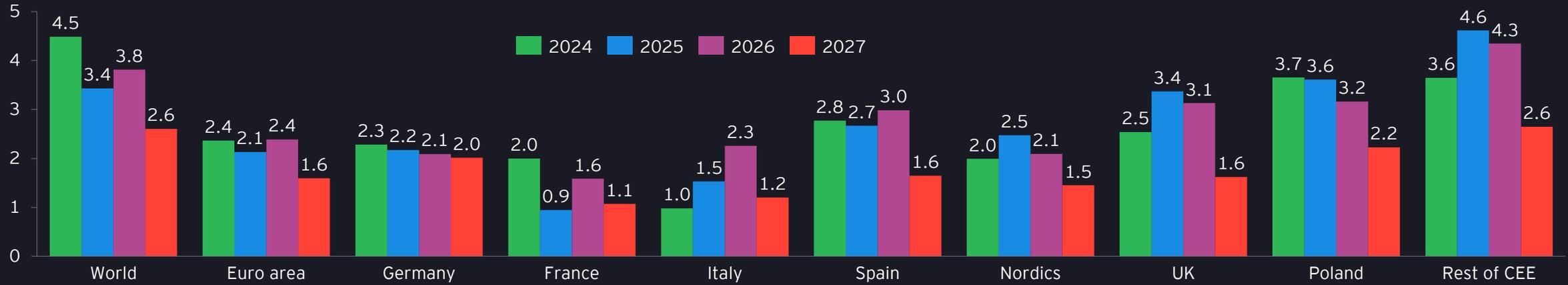


Source: Oxford Economics, EY EAT forecast, EY Item Club (UK forecast), EY Parthenon (US forecast).

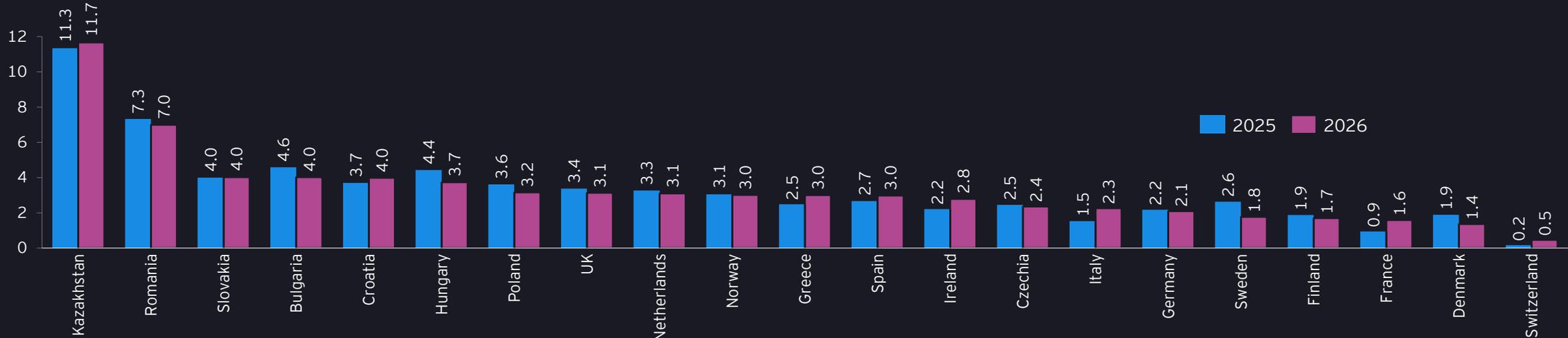
Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Czechia, Slovakia, Hungary, Romania, Bulgaria, and Croatia.

# Euro area inflation is now expected to run slightly above target, averaging 2.4% this year, but falling below 2% next year, provided the energy shock proves temporary and reverses

Inflation in 2024-2027 (in percentage)



Inflation in 2025 and 2026\* (in percentage)



Source: Oxford Economics, EY EAT forecast, EY Item Club (UK forecast), EY Parthenon (US forecast).

Nordics include Denmark, Finland, Norway and Sweden; rest of CEE includes Czechia, Slovakia, Hungary, Romania, Bulgaria, and Croatia.

\* For Sweden, CPIF; for Finland and the euro area, HICP; for others, CPI.

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